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UNITED STATES
BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

7
8 **IN THE UNITED STATES BANKRUPTCY COURT**
9 **FOR THE DISTRICT OF ARIZONA**

10 In re:)
11 CHARLES THOMAS BROWN d/b/a TOM) Proceedings Under Chapter 7
BROWN PREFERRED TRUST COMPANY,) No. 97-14228 PHX GBN
12)
Debtor) Adversary Proceeding No.
13) 99-00746-*ECF*
MAUREEN GAUGHAN, Chapter 7 Trustee)
14)
Plaintiff) **MOTION TO INTERVENE**
15)
v.)
16)
ANN AKAMINE; DAVE ANDRUCH; et al.)
17)
Defendants)
18)
19)

20 The Attorney General of the State of Arizona, Janet
21 Napolitano, by and through undersigned counsel, moves to intervene
22 in this proceeding on behalf of consumer creditors pursuant to
23 Rule 2018, R.Bkcy.P.

24 The Attorney General has several concerns about the pending
25 lawsuit filed by the Bankruptcy Trustee against investors in Tom
26 Brown Preferred Trust. First, the action controverts long-

1 standing principles of securities law by seeking to impose a duty
2 of inquiry on investors and imputing bad faith to investors for
3 their failure to fulfill that purported obligation. Second, the
4 lawsuit already has caused, and will continue to cause, an undue
5 hardship on innocent members of the public who have suffered
6 financial devastation as a result of Brown's fraudulent actions.
7 Third, the Trustee's lawsuit may result in as arbitrary a
8 disbursement of funds as the original distribution made by Brown
9 because some investors will accept the Trustee's offer of
10 settlement without argument, whereas others will dispute the
11 Trustee's allegations and negotiate more favorable terms. In view
12 of the fact that the Trustee is unlikely to recover most of the
13 investors' principal in any event, the subsequent distribution,
14 even if takes into account the disproportionate settlements, is
15 unlikely to provide a more equitable payout to investors. In
16 fact, because the Trustee and her agents will receive a
17 significant amount of the recovery in fees, the litigation will
18 certainly result in less overall being paid back to investors.
19 Finally, the Attorney General believes that this kind of lawsuit
20 will have a chilling effect on future law enforcement efforts
21 because members of the public are likely to link the Trustee's
22 lawsuit with the civil and criminal actions pursued by the State.
23 In effect, investors are likely to conclude that they should not
24 cooperate with the State in public enforcement actions because
25 such assistance inevitably leads to lawsuits such as the one in
26 question. For these reasons, all of which implicate the public

1 interest, the Attorney General moves to intervene on behalf of
2 consumer creditors in the present action. If granted permission
3 to intervene, the Attorney General would move to require the
4 Trustee to present a detailed cost/benefit analysis demonstrating
5 how this action will provide a net benefit to the bankruptcy
6 estate.

7 **MEMORANDUM OF POINTS AND AUTHORITIES**

8 The Bankruptcy Trustee has filed suit against numerous Brown
9 Preferred Trust investors alleging that the investors received
10 preferential transfers pursuant to 11 U.S.C. §547; fraudulent
11 transfers pursuant to 11 U.S.C. §548 and A.R.S. §44-1001 et seq.;
12 and/or were unjustly enriched. The Trustee seeks to recover
13 payments made to investors up to eight years before the filing of
14 the lawsuit. Upon information and belief, the Bankruptcy Trustee
15 has filed suit against numerous investors who never received a
16 return of their principal, much less profits on their investment.

17 The Attorney General recognizes that payments received by
18 investors within 90 days of the filing of the bankruptcy petition
19 are voidable as preferences pursuant to 11 U.S.C. §547, and does
20 not dispute the Trustee's claims to these amounts. She does,
21 however, question the Trustee's efforts to recover as fraudulent
22 conveyances payments made to investors within one year of the
23 bankruptcy filing. The investors can defeat the Trustee's claim
24 of fraudulent conveyance if they can show they gave "reasonably
25 equivalent value" for the payments they received and they accepted
26 the payments in "good faith." 11 U.S.C. §548(C). In cases where

1 investors in a Ponzi scheme have received back less than they paid
2 in, the courts have held that the investors have given "reasonably
3 equivalent value" for the payments they did receive from the
4 operator of the scheme. *In re United Energy Corp.*, 944 F.2d
5 589(9th Cir. 1991).

6 Moreover, as the Trustee has acknowledged, "most investors
7 were completely unaware of Mr. Brown's fraudulent scheme." Letter
8 of John J. Fries to Defendants named in the Bankruptcy Trustee's
9 Complaint dated November 9, 1999. Therefore, the investors
10 accepted the payments in good faith. The Trustee contends,
11 however, that the investors *should have known* that Brown was
12 operating a Ponzi scheme because the Arizona Corporation
13 Commission issued a Cease and Desist Order against him in 1968.
14 This assumption by the Trustee is particularly disturbing, in the
15 Attorney General's view, because it controverts well established
16 law regarding the duties of parties to a securities transaction.
17 As the Arizona Court of Appeals stated in *Trimble v. American*
18 *Savings Life Insurance Co.*, "the [securities] statutes do not
19 require investors to act with due diligence" 152 Ariz.
20 548, 553, 733 P.2d 1131, (App. 1986). In effect, the Trustee, by
21 attempting to impose a duty of inquiry on the investor, unfairly
22 penalizes consumers for failing to do something the law has
23 heretofore never required them to do.

24 Moreover, the Corporation Commission Order cited by the
25 Trustee merely enjoined Brown from technical violations of the
26 Securities Act; there is no mention of fraud in the order.

1 Therefore, even if an investor had inquired, the investor would
2 have not obtained information that would lead him or her to
3 suspect that Brown was engaged in fraudulent conduct. In effect,
4 by the Trustee's own admission, most investors will have a defense
5 of good faith to the Trustee's claim. and, assuming they did not
6 receive payments exceeding their principal investment, will have
7 given reasonably equivalent value for the payments they received.
8 In short, they will have a defense that will defeat the Trustee's
9 claim for fraudulent conveyance.

10 Assuming that investors who did not receive more than a
11 return of their principal have given reasonably equivalent value,
12 it follows that they were not unjustly enriched. Therefore, this
13 theory put forth by the Trustee should fail as well. (In any
14 event, it should cover only payments made within three years of
15 the bankruptcy petition because the statute of limitations in
16 Arizona for unjust enrichment is three years.)

17 Unfortunately, only those investors who can afford to hire an
18 attorney are likely to raise these defenses to the Trustee's
19 action. Those who received little in return from Brown or who
20 are suffering financial hardship as a result of this fraud are
21 likely to settle with the Trustee as quickly as possible to avoid
22 incurring further expense. Those who received significant
23 payments from Brown, however, have more incentive to fight the
24 Trustee's action. These investors may prevail in this action, or
25 at the very least, will be able to negotiate a more favorable
26 settlement of their case. In the end, therefore, those who

1 suffered most from this scam and who are now financially
2 vulnerable may end up contributing a far greater share to the
3 estate than those who actually received a greater return on their
4 investment. Moreover, by the time the fees to the Trustee and her
5 agents are paid out, much less money will be available to
6 distribute to investors. The final outcome of this whole
7 endeavor, therefore, may be a distribution that is significantly
8 smaller in amount, but just as arbitrary as the original payout by
9 Brown.

10 The Attorney General also believes that this action
11 ultimately may hinder the ability of law enforcement officials to
12 pursue these kinds of fraud actions in the future because many
13 people tend to view public prosecutors and the Bankruptcy Court as
14 part of the same governmental system. As a result, members of the
15 public may believe that those who cooperated with the state
16 prosecutors in this matter contributed, in large part, to the
17 current lawsuit against the investors. Such a belief may inhibit
18 other investors from coming forward in the future to complain
19 about, or offer assistance in, public enforcement actions against
20 other promoters of fraudulent investment schemes.

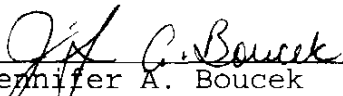
21 CONCLUSION

For the foregoing reasons, the Attorney General requests permission to intervene in the captioned proceeding. The public interest would be served by allowing the Attorney General to move to require the Trustee to perform a cost benefit analysis to

1 ensure that the pending action is likely to produce a net benefit
2 for the bankruptcy estate.

3
4 Dated this 11th day of January, 2000.

5 JANET NAPOLITANO,
6 Arizona Attorney General

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9 Jennifer A. Boucek
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14 COPY of the foregoing
15 mailed this 11th day of
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